In contrast, classical development theory and new trade literature go beyond the static welfare gains from trade creation and diversion effects when analysing the effect of TAs. Developing countries can use TAs to overcome limitations of their domestic market size in the industrialization process (Dahi and Demir, 2013). Such potential increases in the effective market size could help industries in developing countries achieve economies of scale and increase the skill content of production and exports, which in turn could improve the market penetration of exports of developing countries in developed markets in industrial products (Fugazza and Robert-Nicoud, 2006). Also, due to similarities in production patterns and resource base among developing countries, incentivising trade by lowering barriers could facilitate appropriate technology transfer, according to the needs of developing countries (UNIDO, 2006). Of particular relevance for developing countries, it is argued that the products that countries export matter for long-term economic performance. If a country exports products from industries that are more technology-intensive, these are likely to create input-output linkages and spillover effects in human and physical capital accumulation and innovation (Hausmann, Hwang and Rodrik, 2007). Furthermore, by allowing for factor accumulation, TAs can reduce intra-block trade barriers and increase competition and access to cheaper intermediate goods, triggering changes in industrial production in member countries. As such, TAs among “South” countries can reduce intra-South barriers and lead to industrialization of the region (Puga and Venables, 1998). In this context, what matters are not static gains from TAs, but dynamic gains in industrial development. If South-South TAs truly promote industrial development of member countries, they might be desirable even if there are short-term losses due to trade diversion (Dahi and Demir, 2013). Other arguments in the development literature emphasize the asymmetries in bargaining power between “North” and “South” countries, which could lead to worse outcomes for developing countries if their policy space gets restricted (Thrasher and Gallagher, 2008). To the extent that these arguments hold true, developing countries could be better off entering into South-South rather than North-South agreements, or at least should pursue both kinds of agreements.

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